UNITED STATES DEPARTMENT OF AGRICULTURE

Bureau of Agricultural Economics
and
Extension Service

Farm Bookkeeping and the Federal Income Tax

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Federal Income Tax Requirements for Farmers

1. Who must file a return?

A single person, or married person not living with husband or wife, with a gross income of $500 or more.

A married person living with husband or wife, with a gross income of $624 or more. The personal exemption under the regular income tax is still $1,200 but because of the victory tax a return must be filed if gross income is $624 or more.

A return MUST be filed if the gross income reaches the specified amount even though subsequent deductions mean that no tax is due.

A farmer counts as gross income all receipts from farm and from nonfarm sources, including the value of any merchandise received in exchange for farm products or services to others.

2. When is the return due?

For the income of the calendar year 1943 two kinds of reports are required under the terms of the Current Tax Payment Act of 1943. A declaration of estimated tax must be filed on or before December 15, 1943, by farmers who get at least 80 percent of their gross income from farming. Others must file declarations on or before September 15, 1943. A final return covering the calendar year 1943 is due on or before March 15, 1944. A farmer who regularly uses a fiscal (farm) year for his accounting records and who gets at least 80 percent of his gross income from farming must file a declaration of estimated tax on or before the fifteenth day of the last month of his fiscal year and a return not later than 2½ months after the close of his fiscal year.

3. Where and with whom must the income-tax return be filed?

With the Collector of Internal Revenue in the internal revenue district in which the person lives or has his chief place of business. It may be filed by mail or in person.

4. What forms are needed?

The Declaration of Estimated Tax (Form 1040 ES) and the Individual Income Tax Return (Form 1040) are needed by all farmers. The Schedule of Farm Income and Expenses (Form 1040F) also is required for those who report on a cash basis, and is optional for those who report on an accrual basis. All three forms can be obtained from Collectors of Internal Revenue, and usually are also available at banks, post offices, and similar places.

THERE IS NO SUBSTITUTE FOR A CAREFUL STUDY OF THE FORMS

The purpose of this statement on Farm Bookkeeping and the Federal Income Tax is to present some of the requirements for making adequate summaries of the farm business for Federal income-tax returns and to help farmers understand some of the problems involved. This is not a set of directions for setting up a system of farm accounts, nor is it a complete set of instructions for filling out an income-tax blank. But if this statement is carefully studied and its suggestions are followed, many farmers will find they can readily arrange and summarize their business records and fill out the income-tax forms. Problems peculiar to particular situations usually can be settled best after consultation with Collectors of Internal Revenue.

Farm Bookkeeping and the Federal Income Tax [1]

Ability to summarize their financial transactions systematically is of vital importance to the millions of persons subject to the provisions of the Federal income-tax laws. Farm people are no exception. Inability to summarize his business dealings correctly and completely may even be costly to an individual farmer.

The individual income-tax liability is a **personal** liability. The farm enterprise as such has no income-tax liability except in the case of incorporated farms. In the usual situation the "net profit" of the farm enterprise is taxable only because it is personal income of the owner or the operator. As farmers are closer to their business than most other taxpayers, the separation of items that are personal from those that are business, as required in the law, becomes a particularly important problem. Each taxpayer must think through these separations as they relate to his own operations, as some of the items may be business in one situation and personal in another, or may be divided in various proportions. Thus, for a farmer as an individual the "net farm profit" may be only one of the sources of income and there may be a number of personal expenditures that represent permissible deductions from his personal income. The discussion that follows is concerned primarily with accounting for those items that enter into determining the net farm profit. The references to other personal income and deductions are intended mainly to suggest a few of the reasons why a record of

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[1] This statement has the approval of the Bureau of Internal Revenue.

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nonfarm personal and family items also can be helpful in the preparation of the return.

Records for Tax Purposes

Farm people have rather generally managed their affairs without formal bookkeeping, as the principal requirements of their business and personal financial relationships with others have required very few documentary records. The extension of business and industrial practices to farm operation has led many farmers to study their own performance, using written records. Such records now have added usefulness as basic information for preparing income-tax returns.

Basically the principles involved in setting up accounts are relatively simple. Bookkeeping for income-tax returns is more simple than that needed for an adequate study of operating performance. State and Federal agencies have account books which will serve both purposes and can help farm people in their bookkeeping. Other sets of forms also can be obtained. The facts are more important than the form.

Those farm people who have regularly kept written accounts of their business operations or systematically saved various bills and other memoranda of financial transactions usually have been able to rearrange their facts for income-tax filing in a reasonable amount of time each year. Some orderly arrangement of facts supported by evidence is now more than ever worth a farmer's time, not only as a help in guiding the business that provides his income, but also as a help in meeting his obligations under the income-tax laws. The Bureau of Internal Revenue has never insisted that taxpayers keep books in any special way of its devising. Any of the recommended farm-account books can be used to good advantage as a "work sheet" for 1943. Effort spent now in lining up facts for 1943 will be good practical experience toward keeping current records during 1944.

Farmers who have not previously reported will need to study the requirements and make decisions regarding the handling of certain items in their returns. Some of the decisions will be particularly important for those who previously have kept no formal accounts. Those who have reported previously will have made these decisions as to procedure. But under certain conditions that are pointed out later, they may change their methods.

Explanations here offered are incomplete with respect to many points of practice in bookkeeping. The many transactions essentially of the same kind but differing slightly in minor details make bookkeeping seem complicated. On matters of income-tax law, and on interpretations of the prevailing regulations thereunder, many of the complications that appear result from the necessity for providing general rules to cover a great many different individual situations that actually occur rather infrequently.

Hence, for the most part, only the general principles have been stated for the convenience of those farm people who have usual situations. Those who have exceptional problems may need special help from Collectors of Internal Revenue, their deputies, or local people who have been instructed in the subject. But, regardless of help asked and received, the taxpayer is responsible for providing information about the facts.

Choosing the Tax Year

For most farmers, a calendar year fits personal and business interests as well as any other 12-month period. Some other period, such as a crop or rental year, can be used if the taxpayer regularly keeps his accounts that way. A "tax year" once established must be used thereafter, until arrangements for a change have been made with the Commissioner of Internal Revenue. Application for a change in year, made by furnishing the information called for in Form 1128, must be made at least 60 days before the close of the fractional part of the year for which a report would be required, to effectuate the change. A report for a fractional part of a year is required because no return can cover a period of more than 12 months. For example, if permission were granted to change the tax year from one ending December 31 to one ending March 31, it would be necessary to file a report covering the 3-month period from January 1 to March 31, in the year in which the change is made. Reports made thereafter would cover 12-month periods ending on March 31 of each year.

Choosing the Accounting Method

A farmer who is just starting a set of books or one who contemplates a change in his system of handling various items will need to consider the alternatives in the light of his individual business. The major choice, of course, is between determining income on a "cash" basis or on an "accrual" basis. Effective reporting requires much the same sort of records regardless of the basis used in computing income. Some of the basic bookkeeping requirements common to both methods of reporting income, as well as some of the differences, are here pointed out to help the farmer in making his choice.

The principal differences between the "cash" and the "accrual" methods of accounting, particularly from the income-tax point of view, lie in the handling of stock or produce carried over from one year to another and in the handling of incomplete financial transactions. Under the cash method only those transactions completed during the taxable year are included in figuring income or expense. For example, grain sold or feed purchased is included in the accounts for the year when payment is made or received. Under the accrual method attention is directed at the income produced or

earned during the taxable year regardless of when the money, or the value, passes from one party to another. The "expenses" for the year include all costs applicable to the year's operations, whether or not the bills have been paid. It is also necessary to have an inventory or list showing the value of all produce, livestock, feed, and supplies on hand at the beginning and at the end of each year. To facilitate the preparation of summaries of income and expense on an accrual basis, appropriate details must be worked into the record. The accrual method technically reflects more accurately the results of the production and business activities for a particular tax year than does the cash method. In ordinary years the differences in the amount of income shown probably are not of special significance.

Farmers have three classes of business property about which certain information should be kept available. These are (1) land, (2) depreciable capital goods, and (3) other goods used in the business. Land does not enter into income or expense under either method of accounting. Gain or loss occurs only in case of sale, and is considered part of the farmer's personal financial activity and not part of the farm-enterprise activity. Furthermore, as gain or loss from the sale of real estate used in the "business" of the taxpayer is subject to certain special provisions in the income-tax laws, it is necessary to have complete information in order to figure tax liability correctly. Often it will be desirable to discuss specific problems with the collector.

"Depreciable capital goods" includes all of the buildings and land improvements (except the owner's dwelling), machinery, equipment, work animals, and breeding and dairy stock. Usually, property of this class has been acquired by purchase. Instead of deducting the cost of these items from the total farm receipts in the year of purchase, the cost is recovered in part during each year of useful life as the property is used up in the productive processes. The part of the cost recovered annually in this way is the depreciation contemplated in the income-tax laws and regulations. It must be taken each year, as it may not be accumulated as a credit and used to reduce taxable income in just any year selected by the taxpayer.

A record of depreciable capital goods may be part of the annual record book or may be kept in a separate book which serves for 6, 8, 10, or more years. In either case to be most useful the record should show information as to date of purchase, original cost, additions, depreciation in previous years and current year, and amount yet to be recovered. The particular form will vary with the type of enterprise. It often is timesaving to group many of the items by ages and types. In any event, a record once started on a sound basis can easily be carried on from year to year by indicating additional purchases or sales and by making the necessary entries to show the depreciation during the current year.

Gain or loss from the sale of buildings and land improvements is treated as coming from a personal financial transaction, as was the case with land. In the case of a sale of machinery and durable equipment, the gain or loss is mingled with those from other transactions completed in the regular course of business. For income-tax purposes this gain or loss can be looked at as an adjustment for overdepreciation or underdepreciation in previous years.

Work animals and breeding and dairy stock may be treated in any of several different ways so long as a consistent practice is followed. If the animals were purchased, they may be treated as capital items, the same as machinery and durable equipment, and depreciation claimed. Under the accrual method there is the additional choice of treating such animals as inventory items along with other crops or products for sale. If the work animals and breeding and dairy stock were raised and the cash method is used, they do not affect the accounts except when sold and then as income to the full amount received from the sale. Under the accrual method such animals may be carried in the inventory during the years before they reach maturity. After they reach maturity they may be transferred to a capital account at the inventory value used at the end of the preceding year. Subsequently, depreciation may be claimed the same as on other capital items.

The third class of property includes the growing livestock, the produce held for sale or for farm use, and the feed and supplies on hand at the end of the accounting period. The farmer on the cash basis presumably has counted the purchased items as expense at the time of purchase, except in the case of items purchased for resale, the cost of which will be deducted from the sales price in computing profit for the year of sale. The farmer on the accrual basis holds them out of expense "on inventory," where they do not affect his income or his expenses until they are converted into cash or some other form.

A list of the property used in the business has a value entirely aside from its value as an aid in computing an annual income summary. A list of property, kind by kind and group by group, with additions and sales appropriately indicated, is an excellent device for evaluating progress from time to time. The entries are part of the record of the whole business and exist primarily for the convenience of the individual farmer.

In addition to the information about the "property used in the business," a record of receipts and disbursements is necessary for both cash and accrual reporting. By definition, under the cash method receipts or disbursements apply in the year when the cash was received or was disbursed. Under the accrual method the date of cash settlement is of no special significance in the assignment of income or expense to a particular year.

A reconsideration of the problems peculiar to his business may lead a farmer to the con-

clusion that it would be desirable to change the accounting method which has been followed in making income tax returns in the past. This can be done by making application for permission to the Commissioner of Internal Revenue. The application must be filed within 90 days after the beginning of the first taxable year to be affected by the change. In order to effectuate a change, adjustments must be made on a basis that will satisfy the Commissioner that income has been properly reflected without prejudice to taxes properly due. The extent of the adjustment necessary will vary with individual situations and is essentially a matter for negotiation with the Commissioner.

The following discussion of farm income and expenses is expressed largely in terms of the income tax forms. The forms are arranged with many typical commodity names and kinds of expenses to save writing and to illustrate classifications. Each reader, however, should substitute the descriptive labels that fit his own particular operations.

Farm Income

Farm income for tax purposes when determined on a "cash" basis may, for convenience, be considered as the sum of four groups of items: (1) The amount of the cash or the value of merchandise or other property received from the sale of livestock which was raised during the taxable year or prior years, (2) the same for crops and produce raised and sold, (3) the profits from the sale of any livestock or other items which were purchased, and (4) other farm income. When income is determined on an "accrual" basis, inventory change must be taken into account, and purchased produce is not separated out as in item 3.

Income from livestock raised:

For livestock raised on the farm, "income" on a cash basis is the total receipts from the sale of the livestock. If livestock is traded for merchandise or other property, the income reported must include the value of the property received in exchange. The entire sale value of animals raised on the farm is "income" in the year of sale; the value added during the year to animals not sold is not counted. On the accrual basis the "income" sought to be taxed is the difference between the sale price and the costs incurred over the entire period of growth. This is found by using inventories. Because of the difficulty of ascertaining actual costs for inventory purposes, farmers may use the "farm price method," which provides for the valuation of inventories at market price less direct costs of disposition. Those with inventory problems peculiar to their operations will do well to consult the collector.

Income from crops and produce raised:

The procedure for reporting income from crops and produce (including livestock, dairy,

and poultry products) raised is similar to that for livestock. Quantities and cash receipts (or value of goods received in exchange) are entered separately for each class of item. If crops are stored on the farm beyond the end of the year (or fiscal period) during which they are raised, all the income falls in the year when the crop is sold when reporting on a cash basis, but only the difference between the amount received and the expense of raising such crop falls in the year of sale when reporting on an accrual basis.

If a loan is obtained from the Commodity Credit Corporation, the farmer may elect to include it in his income in the year in which the loan is received instead of in the year when the commodity is finally sold. Whichever method is elected must be followed in succeeding years unless special permission to make a change is obtained from the Commissioner.

Profits from the sale of livestock or products purchased:

To arrive at the profit figure to be included in income, Form 1040F calls for the following information in addition to the description of the animal or product: (1) The date acquired, (2) the sale price, (3) the cost, (4) the depreciation allowed or allowable for previous years, and (5) the profit. The profit is the amount of the excess of the sales price over the amount representing the depreciated cost; that is, the original cost minus the depreciation allowed (but not less than the amount allowable) since acquisition. If some of the livestock marketed from the farm were *raised* and some previously *purchased*, it may be desirable to discuss with the Collector the questions involved in segregating the two groups. Individual identification may perhaps be waived for small animals like chickens and lambs, and not waived in the case of animals of high value.

Another question that may need to be discussed with the Collector is the matter of a depreciation method. This is important not only in the case of breeding and dairy animals and the like, which were purchased and later sold, but also in the case of draft animals and property in general as mentioned later.

Other farm income:

Values, or amounts, are to be reported for any other items of income arising from the farm business. Included are such income items as payments from the Agricultural Adjustment Agency, merchandise received for produce, machine work, hire of teams, breeding fees, rent received in crop shares, work off farm, forest products, and any other like receipts. In general, anything of value received instead of cash must be treated as income to the extent of its market value.

Hail or fire insurance for growing crops that were injured or destroyed should be included in gross income to the extent of the amount received in cash or the cash equivalent if received in kind.

The value of home-grown farm produce that is consumed by the farmer and his family need not be reported as income, but expenses incurred in raising produce thus consumed should not be claimed as deductions. Separating such expense items may cause some difficulty but a reasonable estimate should be made if the produce consumed on the farm by the farm family is not reported as income. If it is reported as income, no segregation of expense items is necessary on that account.

Earnings from personal services of minors should be included with the income of the parent for income-tax purposes unless under the laws of the State earnings of a minor belong to the minor.

"Other Farm Income" does not include any receipts arising from the sale of the farm or any part of it. Such transactions are considered not part of the farm business, but personal, and are taken care of directly on Form 1040.

Farm Expenses

A proper record of the farm expenses is fully as significant to a farmer as the record of his income. Deductions are often difficult to establish unless one has a record. Many payments are made in relatively small amounts on numerous occasions. If they have been systematically recorded, preparing entries for Form 1040F is reduced to classifying and totaling. In general, disbursements necessary in the production operations of the farm are allowable deductions in arriving at the net farm profit. Expenses are counted in the year in which payment is made in reporting on a cash basis. In reporting on an accrual basis, expenses are counted in the year in which incurred, whether paid or not. Depreciation allowances are to be taken each year.

Labor hired:

Wages paid for farm work done are included, but no allowance for the value of the work of the farmer, his wife, or dependent minor children is deductible. Board furnished to hired labor is deductible only to the extent that it is purchased by the farmer or his family, thus excluding the value of food raised on the farm and used in boarding laborers. The value of rations purchased and furnished to laborers and sharecroppers is deductible as part of the labor expense. Hired household work is deductible only to the extent that the services are used in boarding or otherwise caring for farm laborers, not including the farmer's own household.

Production supplies:

Amounts expended for feed, seed, fertilizers, lime, manure, and all similar supplies purchased and used in the production of crops and livestock are deductible expense items. The value of seed, feed and manure produced and used on the farm is not deductible.

Taxes:

In general, most State and local taxes are deductible, either on Form 1040F as items of farm expense or on Form 1040 as personal taxes paid by the farmer. Property taxes on the farm land, machinery, livestock, and other production items are deductible as farm expenses. The part of the property tax that applies to the dwelling, and household or personal effects, is a *personal,* not a *business* expense, and is entered directly on Form 1040. As will be pointed out later, this distinction is very important now that the return includes a computation of victory-tax liability. Special taxes and assessments, such as levee, drainage, and certain irrigation taxes, are not deductible if they tend to increase the value of the property assessed. Federal income taxes, estate, inheritance, and similar taxes also are not deductible. Taxes, such as those on retail sales, applying to items used in the farm business may be considered as part of the cost of the items. Taxes on gasoline used in operating vehicles as part of the farm business operations are deductible as business expenses. State and local retail-sales taxes paid in connection with the farmer's personal and family expenditures are deductible on Form 1040 whenever the tax has been separately stated, and paid by the purchaser.

Insurance:

Insurance paid in connection with farm operations is deductible. This will include all fire and similar insurance on buildings, machinery, and crops, but not insurance on the farm dwelling or on personal and household effects.

Interest:

Interest paid on obligations, such as mortgages and notes, arising out of the farm business may be deducted as a business expense. Most other interest paid is a personal item and is entered directly on Form 1040.

Rent:

Rent paid in cash is deductible, but rent paid in the form of crops is not deductible, although the expenses incurred in raising the crops may be deducted.

Tools, machinery, and equipment:

The cost of small tools and items of short life used in the business may be deducted as expenses. Automobile operating expenses, repairs and maintenance, and depreciation may be deducted if the vehicle is used entirely for the farm business but if the vehicle is also used for personal travel, the expense must be divided and only that portion corresponding to the relative use in the business is deductible as an expense. The amounts expended for automobiles, farm machinery, farm buildings, and other equipment of a permanent nature are not deductible as expenses, because such expenditures are regarded as investment of capital which is re-

turned to the owner through depreciation allowances prorated over the useful life of the property.

Depreciation:

Depreciation is a deduction from gross profits which is considered to represent that part of the particular item that was used up in producing the income for the year. A reasonable allowance for depreciation with respect to farm buildings (except the farmer's own dwelling), farm machinery, automobiles (in proportion to their use strictly for farm operations), and other physical property may be deducted. There may also be deducted a reasonable allowance for depreciation of livestock acquired for work, breeding, or dairy purposes, if the animals are carried in a "capital" account. If the animals are carried in the "inventory," no depreciation can be claimed as a separate item.

The amount of depreciation in a given year depends upon the "useful life of the property." The period of usefulness varies greatly among different kinds of property. The taxpayer may establish his own tentative plan of depreciation allowances, but once it is accepted by the Bureau of Internal Revenue he will be expected to use this plan thereafter. Thus, it often will be advisable for the individual farmer to discuss his depreciation problem with the collector.

Preparing a depreciation claim for the first income-tax return requires especial care because the general plan adopted at that time must be used in determining depreciation in succeeding years unless special circumstances warrant a change. In any event, as a basis for a consistent depreciation plan and as evidence in support of annual claims for depreciation a farmer will do well to prepare a list of depreciable property. Besides identifying the kinds of property, the list may properly show such facts as the date each item was acquired, the cost, the depreciation allowed or allowable in previous years, the remaining cost to be recovered, and the depreciation allowable this year. These facts are useful in themselves and, once set up, the list may be used year after year.

For any farmer's full list of property the depreciation sum may vary from year to year, depending on when and how many items are added or disposed of during the year.

The sum of the expense and depreciation items constitutes the deduction from gross profits for arriving at a figure for net farm profit. This net-farm-profit figure is the farmer's personal income from his farm operations, the amount which he enters on Form 1040.

Nonfarm Receipts and Expenditures

The desirability of records of nonfarm *personal and family* receipts and expenditures, as distinct from farm *business* records, often is overlooked. For many farm people the personal items are so small or so scattered through the year that they may be difficult to recall or to substantiate unless some systematically kept

record is available. Where the items are large it may be even more important to have a record.

One item of personal income that will mean more to many farmers now than in the past is compensation for work done off the farm. This will be a substantial sum for many who have been working in industrial or commercial establishments for extended periods. Other items of personal income that must be reported include interest on savings accounts, dividends on investments, and other miscellaneous kinds of income. Earnings from personal services of minor children must be included with the income of the parents for tax purposes unless under the laws of the State the earnings of the minor belong to the minor. If a minor has income of his own from property in his own name or held in trust for him, a separate return must be filed if he has gross income of $500 or more, if single, or $624 or more, if married.

Gains or losses arising from the sale or exchange of "capital assets" must be shown on the return. Gain or loss from a "capital asset" receives special treatment depending on the period during which it was held. Under present law, 100 percent of the gain or loss must be reported if the capital asset has been held for 6 months or less. Only 50 percent of the gain or loss is taken into account if the capital asset has been held for more than 6 months. Any profit or loss from the sale of depreciable property and land used in the trade or business of the taxpayer and held more than 6 months is given special treatment. Thus if all or part of the farm has been sold, it would be well to discuss with the collector the question of handling the gain or loss.

Income Tax Net Income

The introduction of the victory tax means that each taxpayer now must determine separately "income tax net income" and "victory tax net income." The general rule in computing income tax net income is that an individual may not deduct personal living or family expenses except certain extraordinary medical expenses. But certain items can be deducted if their amount can be established. A few have been mentioned in connection with similar business items. One example relates to taxes paid. That part of the property tax that is applicable to the farm residence or nonfarm personal property is a deductible personal expense. State and local retail-sales taxes on personal and family-living items are deductible to the extent that they are separately stated and paid by the purchaser. Federal taxes that may be deducted are those on admissions, club dues, telephone and telegraph services, safe deposit boxes, transportation of persons and property, use of motor vehicle or boat, and documents. In no case should a tax expenditure be claimed as a personal deduction if it already has been included in business expenses.

Contributions and gifts to charitable, religious, educational, and certain other organiza-

tions are deductible within certain limits. Contributions to community chests, war funds, churches, Red Cross, United Service Organizations, Boy Scouts, Girl Scouts, and similar groups are among those which may be deducted, but the total deduction is limited to 15 percent of the net income computed without the benefit of such deduction.

Amounts paid as interest on indebtedness not connected with the farm business are deductible, except where the indebtedness arises in connection with the purchase of certain tax-exempt securities; also deductible are losses on bad debts.

The deductibility of certain extraordinary medical and dental expenses was provided by the Revenue Act of 1942. Medical care is defined in the law to include "amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance)." There may be deducted from net income as much of such expenses as exceeds 5 percent of net income computed without benefit of this deduction, with a maximum deduction of $2,500 for a joint return of husband and wife or return of the head of a family, and $1,250 for other individuals.

Income-tax net income then is the sum of the personal-income items, including the net profit from farming, minus the sum of the permitted personal deductions. The graduated surtaxes, beginning with 13 percent, apply to net income minus the personal exemption and credit for dependents. The normal tax of 6 percent applies to the net income reduced by the personal exemption, the credit for dependents, the earned-income credit, and the amount of interest on certain United States obligations.

Victory Tax Net Income

The victory tax net income for farmers who have no income from nonfarm sources will be essentially the net profit from farm operations. It will be larger than income-tax net income because most of the personal items, such as contributions, personal taxes, interest on personal debt, and the like, are not deductible. For the victory tax few deductions other than those that appear in the farm-business summary are permitted.

This emphasizes the importance of keeping separate in the accounts those items which are personal and those which are business. It is particularly desirable to give attention to disbursements that must be divided between the two classes. One example that is important in many States is the State retail sales tax paid on most purchases. That part of such a sales tax that applies to items purchased in connection with the farm business may be deducted as a business expense or considered as part of the cost of such items. No sales taxes, however, that are paid in connection with personal and

family expenditures are deductible in computing victory tax net income, although they are deductible in computing income tax net income. If items of this sort are not clearly identified in a record of some kind it will be difficult to make a correct tax return.

Victory tax net income for most farmers will be the sum of the personal-income items, including the net profit from farming, but excluding capital gains or losses. The victory tax of 5 percent applies to victory tax net income minus the specific exemption of $624. In case of a joint return on which income is reported for both husband and wife the specific exemption is $1,248, unless the victory tax net income of one spouse is less than $624. In this latter case the total exemption permitted on the return is limited to $624 plus the victory tax net income of the spouse having the smaller income. A post-war credit or refund amounting to 25 percent of the victory tax for single persons and 40 percent for married persons, plus 2 percent for each dependent is provided for in the law. The credit may not exceed $500 for a single person, $1,000 for a married couple, and $100 for each dependent. The amount of victory tax actually paid on 1943 income can be reduced if the post-war credit is absorbed currently by credits allowed for payments for life insurance, debt reduction, or war bonds.

Pay-As-You-Go Provisions

The Current Tax Payment Act of 1943 provided certain significant changes in income tax procedure. The major object of this law is to provide that payment of income taxes be timed to agree more closely with the period during which the income is received. For taxpayers whose main source of income is wages and salaries, this is accomplished by providing for withholding or collecting at the source most of their tax liability. Collection at the source, however, is not of special interest to farmers except as they may be employed off the farm by industrial or commercial employers who are required to withhold taxes from wages earned by their employees. Farmers are not required to withhold any taxes from payments to their hired help as wages paid to agricultural labor are specifically exempt from the withholding provisions.

To enable the self-employed, and other taxpayers whose liability is not met by withholdings, to pay their income taxes currently the law provides for the filing of "declarations of estimated tax." For taxpayers generally, this declaration for 1943 was due on or before September 15, 1943, but for those who receive 80 percent or more of their income from farming a special deadline of December 15 is provided in the law. (Wage workers on farms are not farmers for this purpose.) Beginning in 1944, the declarations for taxpayers generally are due on March 15, while farmers have until December 15 each year.

The declaration of estimated tax (Form 1040 ES) represents the taxpayer's best approximation of his income and victory tax liability for the current year. The amount to be paid by December 15, 1943, is generally the amount of the estimated tax liability on 1943 income minus any payments made to the collector earlier in the year. The farmer with reasonably good records of his financial transactions should have little difficulty in filling in the required form line by line.

The final and exact tax liability for 1943 is determined on a return to be filed on or before March 15, 1944. At this time an adjustment is made for any difference developing because of incomplete information on the year's business at the time the estimate was prepared. For most taxpayers the tax liability in March 1944 will be the equivalent of the 1943 or 1942 tax, whichever is the larger, plus 25 percent of the smaller. (If the smaller of the two taxes is between $50 and $66.67, a flat $50 is forgiven. If less than $50, all is forgiven.) The amount that must be paid in March 1944 will be the amount figured in this way less any amounts paid during 1943 in connection with (1) a return for 1942, (2) a declaration of estimated tax for 1943, and (3) any withholdings from nonfarm income. Incidentally, the taxpayer may postpone payment of one-half of the 25 percent referred to above until March 15, 1945, if he wishes. An examination of the forms will reveal that the task of the farmer who has adequate records is not any more difficult than was the reporting in the past.

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It is clear that a written record of receipts and expenditures is highly important to a farmer when he is preparing his income tax returns. It is intended that a taxpayer's regular accounts, files of receipts, and records of whatever kind, shall be sufficient for filing income tax returns. Generally, any record that suits the taxpayer's needs will serve the tax collector, provided that effective information is available and the taxpayer is prepared to prove the essential reality of claims or statements made. Books as such are not final proof of anything, but in connection with material evidence which the book entries may properly describe, account books are worth the trouble. The usefulness of account keeping, moreover, extends far beyond any single purpose such as income-tax reporting. The analysis of the farm business required in order to decide which is the best of several alternatives as to taxable year, method of determining income, depreciation rates, etc., naturally leads to the use of the records for guidance on questions of farm management. Better farming and farmers better off will be the logical result as farm accounts are used to analyze the financial results of farm operations.

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